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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 477

RKO GENERAL, INC.,

Petitioner,

v.

MARGOT NEWMARK,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY BRIEF

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Respondent concedes that:

(a) The $8 million Section 16(b) judgment below is without precedent (Brief for Respondent in Opposition ("Brief in Opp."), p. 7).

(b) RKO realized no cash or cash equivalent profit as a result of the transaction in issue (*id.*, p. 15).

(c) RKO would face no possibility of Section 16(b) liability if, on the day of the Central-Frontier merger and stock purchase, the merger took place before the stock purchase. (Respondent bases her Section 16(b) case upon a "which came first?" dissection of a single transaction. If, on September 18, 1967, the merger came first, RKO would face no Section 16(b) liability; but since the stock purchase came first, says Respondent, RKO is liable for $8 million. (*Id.*, pp. 4, 5, 7, 8-9, 16.))

However, Respondent asks this Court not to consider the fundamental federal securities issues raised by this case because, Respondent contends, Section 16(b) merger cases such as the one at bar are unlike the Section 16(b) conversion and recapitalization cases on which the Circuit Courts are in disagreement (*id.*, p. 10). Additionally, Respondent asserts, the merger case at bar is unlike any other merger case (*id.*, pp. 7-8). Neither of these propositions is tenable.

1. This Section 16(b) merger case raises the same Section 16(b) definitional issues ("purchase and sale", "profit realized") as the Section 16(b) conversion and recapitalization cases on which the Circuit Courts are in disagreement (see Petitioner's Petition for a Writ of Certiorari ("Petition"), pp. 18-19, and Brief in Opp., pp. 10-11). The Court of Appeals below certainly thought so. The Court of Appeals relied upon the Second Circuit decision in *Blau* v. *Lamb*, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967), a conversion case (see Petition, pp. 3a, n. 2, 4a, 10a-11a, 13a, 17a), and explicitly "rejected" the conflicting rule of the Third Circuit, as stated in *Heli-Coil Corp* v. *Webster*, 352 F.2d 156 (3rd Cir. 1965), another conversion case (Petition, p. 3a, n. 2; see also p. 12a).

Reliance by the Second Circuit upon conversion cases is understandable. Corporate reorganizations, whether by way of merger or conversion or reclassification of securities, merit different Section 16(b) treatment than ordinary cash purchases and sales of securities. And reorganization cases, whether involving mergers or conversions, raise identical Section 16(b) "purchase and sale" and "profit realized" definitional questions. For purposes of these questions, which are before this Court here, it makes no differ-

ence whether the reorganization is intra-corporate or extra-corporate.

Mr. Justice (then Judge) Blackmun has noted that the Circuit Courts are in conflict on these fundamental Section 16(b) questions. *Petteys* v. *Butler*, 367 F.2d 528, 539 (8th Cir. 1966) (dissenting opinion), *cert. denied*, 385 U.S. 1006 (1967). The case at bar provides this Court with a most appropriate opportunity to resolve this conflict.

2. The Central-Frontier merger was a typical corporate merger. Respondent asserts that the Central-Frontier merger was unlike all other mergers because a purchase of securities was a part of the deal (Brief in Opp., pp. 8-9). It is quite true that the Central-Frontier merger was dependent upon RKO's stock purchase and vice versa. However, this arrangement is hardly unusual. Quite frequently corporate mergers are coupled with contemporaneous stock purchases, usually buy-out purchases from the controlling shareholders of one of the merging corporations.

The decision below creates great uncertainty in the business community with respect to such mergers and real danger of huge insider liability. In the present uncertain state of the law, mergers in the interest of the shareholders involved (as the Central and Frontier shareholders overwhelmingly agreed here) and in the public interest (as the Civil Aeronautics Board ("CAB") found here) might nevertheless produce enormous insider penalties if the stock market happens to jump at merger closing time.

This Court, rather than the Circuit Court, should determine if ordinary, desirable commercial transactions are to be burdened with such incalculable potential liability.

3. Respondent's Section 16(b) case is based upon the supposed "purchase and sale" of *Central* securities (Brief in Opp., pp. 8-9, 16). Respondent would thus apply Section 16(b) liability to half of a transaction.

RKO was in fact purchasing *Central-Frontier* securities. Central securities were purchased only for immediate conversion into Central-Frontier securities. The undisputed purpose of the purchase was to allow RKO to maintain its controlling interest in Central-Frontier, the merged company (Petition, p. 7). As the Court of Appeals found (Petition, pp. 11a-12a, n. 5), RKO was obliged upon receipt of the Central securities to convert them by merger into Central-Frontier securities. And respondent does not and cannot suggest that RKO has ever "sold" its Central-Frontier securities. The Central-Frontier securities received pursuant to such conversion, on the very day of the purchase, are still held by RKO.

4. Respondent's theory of speculative abuse relates neither to a Section 16(b) "purchase and sale" nor to any Section 16(b) "profit realized."

Respondent contends that RKO was in a position to engage in speculative abuse of the sort proscribed by Section 16(b) because prior to September 18, 1967 RKO could have elected to perform the merger and stock purchase or to back out of the merger and stock purchase (Brief in Opp., pp. 8, 16).

However, Section 16(b) applies not to a purchase or no purchase, but to a "purchase *and sale*," an in-and-out trade (see Petition, pp. 26-27). Here there was none.

RKO got "in" and never got "out." (See Petition, pp. 30-32.)

No matter which way RKO decided to go, there was no opportunity for speculative abuse[1] in connection with an in-and-out Section 16(b) purchase and sale. If, as Respondent hypothesizes, RKO decided to call off the merger and stock purchase, there would have been no purchase and no sale—neither an "in" nor an "out" transaction—and, of course, no "profit realized." By performing the merger and stock purchase, RKO made a purchase but no sale; RKO came "in" and never went "out." And by making a long-term investment in Central-Frontier which is yet to be liquidated, and which could be liquidated today only at a loss (Petition, p. 13), RKO again has "realized" no "profit." The Second Circuit's contrary conclusion, which conflicts with the Third Circuit's decision in *Heli-Coil Corp.* v. *Webster*, 352 F.2d 156 (3rd Cir. 1965), and with any economic or common sense definition of "realized profit," surely merits this Court's reexamination.

5. Respondent erroneously represents that Petitioner's final argument—that Section 414 of the Federal Aviation Act, 49 U.S.C. § 1384, forecloses Section 16(b) liability

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[1] In discussing the opportunity for speculative abuse, Respondent states that the proxy statements to the Central and Frontier shareholders did not disclose the terms of RKO's purchase agreement or that approval of the agreement by the CAB was a prerequisite to the merger. (Brief in Opp., p. 17.) This was not the case. The proxy statement disclosed the essential terms of the purchase agreement (J.A. 264a, Ex. A, p. 3), contained the full text of the merger agreement (*id.*, Ex. "A"), and noted that performance of the merger was conditional upon CAB approval (*id.*, p. 5).

Respondent also impliedly criticizes the absence of any public announcement of the merger or stock purchase agreements until the day of the merger and stock purchase agreements (Brief in Opp., p. 2). These agreements were executed as of May 4, 1967, and were publicly announced the very same day (Petition, p. 8). No law or government regulation required any public announcement any earlier.

here—was not raised in the Court of Appeals below. Respondent concedes that RKO made this argument in the District Court (Brief in Opp., n. at p. 17) but suggests that this argument was not advanced in the Court of Appeals (Brief in Opp., pp. 17-18). This is not so. RKO's Section 414 argument was made to the Second Circuit on petition for rehearing.[2]

Thus, it is entirely appropriate for RKO to contend here that Section 414 entrusts the CAB with exclusive authority to approve all aspects of airline mergers and related transactions. The CAB is not merely entitled to exercise such authority; it is obliged to do so. In *Schwabacher* v. *United States*, 334 U.S. 182 (1948), this Court had occasion to interpret an analogous statute, Section 5 of the Interstate Commerce Act, 49 U.S.C. § 5, which empowers the Interstate Commerce Commission ("ICC") to approve and authorize mergers. This Court noted that the ICC's authority to approve mergers was "plenary and exclusive and independent of all other state or federal authorities" (*id.*, at 197). *Schwabacher* confirmed that ICC approval of a merger necessarily includes approval of the terms thereof and their effect upon shareholders and others, and that such approval, while reviewable upon appeal of the ICC proceedings, forecloses any collateral claims based upon any law other than the ICC merger statute.

CAB approval of an airline merger has the same effect. Section 414 of the Federal Aviation Act obliges the CAB to examine all aspects of the proposed airline mergers, including impact upon shareholders. And the CAB's ap-

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[2] This argument was made at pages 6-7 of the Petition of Defendant-Appellant RKO General, Inc. for Rehearing or, Alternatively, for Rehearing En Banc.

proval of an airline merger and the terms thereof cannot be overturned at some later date in a collateral proceeding.

Accordingly, we submit, a Section 16(b) claim cannot properly be based upon any transaction approved by the CAB pursuant to Section 414. Any such claim constitutes a collateral attack upon the CAB's authority with respect to airline mergers. Here, for example, the CAB approved the merger and related $7.5 million stock purchase, specifically finding that the terms of the merger and stock purchase were not unfair "to either carrier, the stockholders of each, the Federal Government, or the general public." (J.A. 317a.) The $8 million judgment below would more than double the stock purchase price approved by the CAB, thereby drastically changing the merger terms approved by the CAB.

The CAB's authority over airline mergers pursuant to Section 414 would be substantially derogated if the terms of a merger could be overturned *ex post facto*, without CAB scrutiny or approval, by means of a minority shareholder Section 16(b) action.

CONCLUSION

The questions raised by this case are fundamental securities questions of great public importance. Corporate mergers, securities reclassifications and other types of corporate reorganizations are vitally affected by them. At present there are no answers to these questions upon which businessmen and their lawyers can confidently rely. The Circuit Courts are in disagreement. The economic cost of such uncertainty is very high, as the $8 million judgment here attests. Review by this Court is urgently required.

Respectfully submitted,

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